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No. 01-1648

IN THE
Supreme Court of the United States

LONNIE GLOVER AND DAWN GLOVER,
AND ALL OTHERS SIMILARLY SITUATED,
Petitioners,

v.

STANDARD FEDERAL BANK, *ET AL.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF OF NATIONAL ASSOCIATION OF CONSUMER ADVOCATES, PUBLIC CITIZEN, NATIONAL HISPANIC HOUSING COUNCIL, AND NATIONAL COMMUNITY REINVESTMENT COALITION AS *AMICI CURIAE* IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

LYNN W. JINKS, III
Counsel of Record
JINKS, DANIEL, CROW
& SEABORN, L.L.C.
219 North Prairie Street
P.O. Box 350
Union Springs, AL 36089
(334) 738-4225

ELIZABETH C. SMITHART
ATTORNEY AT LAW
214 North Prairie Street
P.O. Box 663
Union Springs, AL 36089
(334) 738-8683

Counsel for Amici Curiae

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QUESTIONS PRESENTED

1. Whether a class may be certified to challenge a lender's uniform practice of paying premiums to mortgage brokers for directing loans at above-par interest rates to that lender as a violation of the prohibition on referral fees under § 8(a) of the Real Estate Settlement Procedures Act of 1974, 12 U.S.C. § 2607(a), where the premiums are paid pursuant to standard agreements and admittedly bear no relation to any actual services performed by the broker.

2. Whether a court must defer to an agency policy statement that was not issued pursuant to notice-and-comment rulemaking and that lacks the force of law, when that policy statement purports to interpret regulations that simply mirror the statutory text and reverses the longstanding prior position of the agency.

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INTEREST OF *AMICI CURIAE*[1]

The National Association of Consumer Advocates ("NACA") is a membership organization consisting of private and public sector attorneys, legal services attorneys, law professors, and students whose primary practices and areas of specialty involve consumer protection issues. NACA was a member of the Negotiated Rulemaking Advisory Committee on Mortgage Compensation and Disclosure of the Department of Housing and Urban Development ("HUD").

Public Citizen is a national consumer organization with approximately 150,000 members. This organization has a long-standing interest in preventing large institutions (including the Federal Government) from compelling consumers and workers to forgo remedies and other rights, either as a matter of law or, as here, as a matter of practical necessity. It believes the Court should grant review because the rights that Congress sought to protect under the Real Estate Settlement Procedures Act of 1974 will be undermined if the Eighth Circuit's decision stands.

The National Hispanic Housing Council is an organization dedicated to: identifying local housing needs and problems by providing research, data analysis, and strategic recommendations to those involved in the expansion of housing opportunities and bringing excellence in housing management; acting as a liaison among and between non-profit, community development corporations, community action agencies, local institutions, public and private sector lenders, intermediaries, and other housing development resources; consulting with HUD in improving its accountability, flexibility, and responsiveness to Hispanic constituencies; advocating on behalf of and with members

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[1] Pursuant to Supreme Court Rule 37.6, counsel for *amici* represents that it authored this *amicus* brief and that no entity other than *amici*, their members, or their counsel made a monetary contribution to the preparation or submission of the brief. Counsel for *amici* represents that counsel for all parties have consented to the filing of this *amicus* brief. Letters reflecting their consent have been filed with the Clerk.

of the National Hispanic Housing network for ongoing legislative, statutory, budgetary, programmatic, administrative, and managerial reform; addressing neglect, underrepresentation, and systematic alienation of the Latino community; and communicating and collaborating with other communities of color and their housing networks on issues of mutual concern.

The National Community Reinvestment Coalition ("NCRC") and its over 700 community members work to increase fair and equal access to credit, capital, and banking services. NCRC seeks to support long-term solutions to provide relief to consumers against predatory lending practices and to fight discrimination in lending.

STATEMENT

Buying and financing a home is a typical consumer's largest and most complex financial transaction.[2] The complexity of the transaction coupled with the infrequency of the average homeowner's experience with mortgage transactions makes consumers especially vulnerable to being overcharged for loan origination services.[3] The broad array of loan products now available to consumers has rendered the home purchase and mortgage process significantly more complicated and confusing.[4] As a result, the average residential borrower must rely on the mortgage broker or a loan officer when choosing mortgage

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[2] *See* Testimony of Gail Laster, General Counsel, U.S. Department of Housing and Urban Development, Before the Subcomms. on Financial Institutions and Consumer Credit and on Housing and Community Opportunity of the House Comm. on Banking and Financial Services, 105th Cong. (July 22, 1998).

[3] *See, e.g.*, S. Rep. No. 93-866 (1974), *reprinted in* 1974 U.S.C.C.A.N. 6546, 6547 (consumers' lack of understanding about the settlement process and its costs makes it difficult in a free market for settlement services to function at maximum efficiency).

[4] *See* Testimony of James McCabe on behalf of the Mortgage Bankers Association of America Before the Subcomm. on Housing and Community Opportunity of the House Comm. on Banking and Financial Services, 105th Cong. (Mar. 27, 1998).

products. Yet, the industry promotes a secret incentive system designed to encourage brokers to recommend higher interest rate loans that will result in fees to brokers that are wholly unrelated to whether anything is owed to the broker for its services.

Kickbacks and referral fees are a commonplace, long-standing practice in the residential mortgage industry. *See* Paul Barron, *Federal Regulation of Real Estate and Mortgage Lending* ¶ 2.04, at 2-25 n.1 (3d ed. 1992). Congress attempted to end those practices in 1974 when it enacted the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. §§ 2601 *et seq.*, which contains a prohibition against the giving or receiving of "any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person." 12 U.S.C. § 2607(a).

In 1992, after the emergence of the mortgage brokerage industry, Congress amended RESPA to make it expressly applicable to mortgage originations. At that time, HUD did not take a position on the legality of yield spread premiums. *See Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers*, 64 Fed. Reg. 10080, 10082 (1999) ("1999 Policy Statement") (Pet App. 137a). HUD did, however, issue rules requiring that all payments to brokers be disclosed, including yield spread premiums. *See* 12 U.S.C. § 2603(a), 24 C.F.R. Pt. 3500, App. A. This requirement caused an uproar in the mortgage industry, which claimed that consumers "did not benefit from the disclosure [of yield spread premiums]" because disclosure of such "indirect" fees would "confuse" and "mislead" borrowers. *See* 1999 Policy Statement, 64 Fed. Reg. at 10083 (Pet. App. 139a).[5]

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[5] A former HUD employee has described his experience of receiving more than 2,000 letters from mortgage brokers protesting HUD's sug-

A substantial number of borrowers obtain home mortgage financing by securing the services of a mortgage broker. *See id.* at 10080 (Pet. App. 129a). These brokers provide some services to borrowers, such as completing standard loan applications, helping obtain appraisals, getting credit reports, and providing all origination services necessary to present a fundable loan. Importantly, mortgage brokers do not fund the mortgage loans that form the basis of this litigation and, therefore, do not own the loans at the time of closing. Loans originated by mortgage brokers, but funded by mortgage lenders, such as Respondent Standard Federal Bank, are known as "table-funded" transactions. 24 C.F.R. § 3500.2. In table-funded transactions, brokers steer borrowers to one of the many lending institutions with which the broker has a standard contractual relationship.

Each day lenders will send their brokers a "rate sheet" showing the interest rates at which the lenders are willing to loan money. The rate sheet constitutes the lender's agreement to pay a specified fee in exchange for the broker's referral of an inflated interest rate, or above-par, loan.[6] The more an interest rate exceeds the par rate on a particular loan, the greater the amount of the yield spread premium paid to the broker. In this manner, lenders reward brokers for sending them business where the borrower has been assessed an above-market interest rate. The mortgage broker decides the terms of the transaction from among the options offered on the rate sheet. This includes determining what the interest rate will be on that particular transaction by reference to the rate sheets. The borrower is prohibited by the lender from see-

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gestion that brokers should mention yield spread premiums on the federally mandated HUD-1 disclosure form. Grant E. Mitchell, *RESPA the Inside Story*, 60 Mortgage Banking 26, 1999 WL 12029502 (Nov. 1, 1999).

[6] A "par loan" is a loan that a lender will fund at 100 cents on the dollar, as shown on the rate sheet. An "above-par loan" is one that is placed at an interest rate higher than "par" and for which the lender is willing to pay more than 100 cents on the dollar.

ing these rate sheets and cannot therefore learn of the availability of better interest rates or the costs of accepting a higher interest rate.

Mortgage brokers are paid for their services in a variety of ways. They usually charge a "loan origination fee" to compensate them for their work in helping to arrange the loan. They also charge specific fees for certain services such as document preparation fees, processing fees, and application fees. These fees are usually paid directly by the borrower at closing.

Brokers also commonly receive indirect compensation from the lenders with whom they have referral agreements. These payments are referred to variously as "yield spread premiums," "service release premiums," or "back funded payments." 1999 Policy Statement, 64 Fed. Reg. at 10081 (Pet. App. 130a). These fees are based upon the interest rate that the broker locks in for the lender.

SUMMARY OF ARGUMENT

Petitioners collectively seek redress for a violation of RESPA. By denying their right to proceed as a class, the Eighth Circuit has made it impossible, as a practical matter, for a court to determine whether the practices of Standard Federal – or any other mortgage lender – violate RESPA. The Eighth Circuit's decision also creates a split in legal authority among the circuits that will cause great uncertainty in the home lending market and disparate treatment among consumers located in different geographic regions of the country. Further, borrowers and their counsel have little incentive to pursue claims that range from $500 to $2,500, particularly in light of the heavy discovery burden required with the "reasonableness" liability test adopted by the Eighth Circuit.

Section 8 of RESPA contains a broad, straightforward prohibition against kickbacks and referral fees. Petitioners contend that Standard Federal's practice of paying yield spread premiums to mortgage brokers violates this prohibition. This question is appropriate for determina-

tion on a classwide basis because the practices of Standard Federal are uniform as applied to all putative class members.

The sole basis for the Eighth Circuit's decertification order was its deference to HUD's 2001 "Clarification" of its Policy Statement. *See* 1999 Policy Statement, 64 Fed. Reg. 10080 (1999) (Pet. App. 126a); *Real Estate Settlement Procedures Act Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b)*, 66 Fed. Reg. 53052 (2001) ("2001 Policy Statement") (Pet. App. 88a). This 2001 Policy Statement states that, in determining whether there has been a violation of RESPA's prohibition against referral fees, each transaction must be looked at individually to determine whether the amount of the yield spread premium is reasonable considering the total compensation paid to the broker. HUD's rationale in its 2001 Policy Statement seeks to prohibit courts from employing the just and efficient class action mechanism to resolve hundreds of thousands of identical consumer claims arising from the same course of corporate conduct and arising under the same federal statute.

In ruling as it did, the Eighth Circuit has given HUD's 2001 Policy Statement the force of law. However, this policy statement did not result from any formal rulemaking process, such as a notice and comment procedure, that would have allowed *amici* and others to be heard. In fact, HUD's 2001 Policy Statement, on which the court below based its ruling, was the result of pressure from the industry to respond to and attempt to reverse the effect of the Eleventh Circuit's *Culpepper* decision, which properly interpreted RESPA's statutory language. *Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324 (11th Cir. 2001), *cert. denied*, 122 S. Ct. 930 (2002).

HUD, in its 2001 Policy Statement, has effectively conferred upon itself the very rate-setting authority that Congress specifically considered, and rejected, in enacting

RESPA, by requiring an inquiry into the reasonableness of a broker's total compensation as a prerequisite to determining whether a yield spread premium violates RESPA § 8(a). Indeed, the Fourth Circuit has recently rejected HUD's attempt, through the same 2001 Policy Statement at issue here, to transform RESPA § 8(b) into a rate-setting statute. *See Boulware v. Crossland Mortgage Corp.*, __ F.3d __, No. 01-2318, 2002 WL 1025101 (4th Cir. May 22, 2002).

HUD's 2001 Policy Statement is itself based on the false assumption that borrowers "choose" to pay yield spread premiums in order to finance the payment of settlement costs and fees instead of paying them directly. The mortgage broker industry has consistently and vigorously resisted any meaningful disclosure to borrowers about the existence or effect of yield spread premiums. Indeed, in its opposition to the petition for a writ of certiorari, Standard Federal scoffs at the notion that a lender might require its brokers to inform borrowers of this supposed "choice." Yield spread premiums are classic kickback payments for referrals exchanged between lenders, such as Standard Federal, and their network of brokers. The borrowers are not participants in or cognizant of these kickback arrangements. Instead, as Congress recognized, borrowers such as the Glovers are the victims of this practice and suffer the resulting increased home loan costs.

ARGUMENT

I. YIELD SPREAD PREMIUMS ARE DESIGNED TO ENCOURAGE BUSINESS REFERRALS, NOT TO FINANCE CLOSING COSTS

A. Yield Spread Premiums Are Marketed And Designed To Promote Business Referrals

The mortgage industry's own representatives admit that yield spread premiums are a "method of enticing mortgage brokers to refer loans to lenders." Robert A. Cook, *Yield Spread Premiums Come Under Attack*, 48

Consumer Fin. L.Q. Rep. 94 (1994). Similarly, counsel for the National Home Equity Mortgage Association ("NHEMA") explains on NHEMA's website that the "uncertainty" surrounding the legality of yield spread premiums hurts lenders that refuse to pay yield spread premiums because they "lose market share." *See* Joe Lefkoff, *HUD Continued Inaction Contributes to the Chaos Associated with RESPA* (1997), *at* www.nhema.org/hudrespa.htm. Payment for referring a borrower to settlement service providers, such as lenders, is precisely what RESPA prohibits. It would be difficult to imagine a practice that is more questionable under the law and that affects more persons than the subject yield spread premium practice.[7]

The mortgage industry's own lawyers warned long ago that the practice of paying yield spread premiums was dubious at best. More than six years ago, one industry lawyer warned:

> Some lenders pay an "overage" to a broker or dealer for "up-selling the rate." This refers to additional payments by an equity lender to a broker for a loan that has a higher-than-expected rate of interest. The extra payment from the equity lender is intended to compensate the broker for bringing to the lender such an attractive, high rate loan. *If a RESPA Sec. 8 violation is asserted, it is debatable whether an equity lender can defend payment of the extra overage money as payment of a thing of value for services rendered.*

Leonard A. Bernstein, *RESPA Invades Home Equity, Home Improvement and Mobile Home Financing*, 48 Consumer Fin. L.Q. Rep. 194, 197 (1994) (emphasis added).

Another industry attorney issued even stronger warnings to the lending and brokerage industry that the practice of paying yield spread premiums in table-funded loans, such as the Petitioners' loan, violates RESPA's anti-kickback provisions:

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[7] In this action alone, some 750,000 persons' claims are at issue. Pet. at 2.

> It is my opinion that three compensation practices – back end points, yield spread differentials and service release fees – are prohibited and illegal. . . . Yield differentials in which pay is based upon the difference between the rate obtained by the broker and the rate at which the lender would otherwise be willing to make the loan can be even more "explosive." . . . [T]he only bona fide way to base compensation on yield differentials, which are sometimes known as overages, is if the deal is clearly a secondary market transaction. If, on the other hand, the lender is table funding the loan, he is violating RESPA Sec. 8 anti-kickback provisions.

HEL Lenders May Be Sued On Broker Referrals, National Mortgage News at 111 (Apr. 3, 1995); *see also* Joe Lefkoff, *Traditional Broker Compensation Under RESPA: Is it Legal?*, Equity Magazine at 18 (Dec. 1994) ("While a yield spread is permitted and justifiable in a secondary market transaction, it is a prohibited fee for referral in the table funded or broker referral situation. The payment, while measured by the yield spread, is for the referral."). Since the inception of this practice, the use of yield spread premiums has been acknowledged as highly suspect by industry and consumer representatives. The availability of a class action thus provides an opportunity to resolve efficiently the legality of the type of yield spread payments made by Respondents and other lenders.

B. Respondent Misrepresents Consumer Choice In Today's Marketplace

The simple duplicity of Respondent's contention that consumers "choose" to pay yield spread premiums in exchange for lower up-front payments is obvious from the fact that the mortgage industry continues to hide yield spread premiums from borrowers. Yield spread premiums are often "disclosed" on the HUD-1 Settlement Statement with designations such as "$2,000 yield spread

premium to Broker POC."[8] The Glovers' HUD-1 makes reference to a "Service release premium to Heartland Mortgage paid by SFB (1.25% = $1550.00 POC)." Pet. App. 212a. As HUD has recognized, these cryptic "disclosures" mean nothing to the average borrower. *See* 1999 Policy Statement, 64 Fed. Reg. at 10087 (Pet. App. 152a-153a). They certainly are not consistent with Respondent's claim that yield spread premiums are presented to borrowers as a financing option. In fact, contradicting its own claim, Respondent describes as "contrived" a situation in which a lender – which purportedly is financing part of the borrower's closing costs through an above-market interest rate – requires its affiliated brokers to inform the borrower of this very deal. *See* Br. in Opp. at 18 n.13.

II. THERE IS NO SUCH THING AS A "REASONABLE" REFERRAL FEE UNDER RESPA

Nothing in the text or legislative history of RESPA supports Respondent's contention that a lender's payment of a referral fee is not a "naked referral agreement . . . illegal under . . . Section 8" so long as the broker performs some specified work for the borrower and the total compensation that the broker receives is "reasonable." Br. in Opp. at 17 n.12. The words "naked," "total compensation," and "reasonable" are not even in § 8(a) or (c) of RESPA. Such an analysis simply stands RESPA's prohibition against kickbacks and referral fees on its head. The statute prohibits *all* kickbacks and referral fees – no matter how great or small their cost, no matter how great or small the broker's "total compensation." Nothing in the plain text of § 8(a) or (c) supports a reading that a referral fee becomes legal simply because it is part of an overall fee paid to a broker that is "reasonable."

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[8] Translation: The lender has made a payment outside closing ("POC") of $2,000 to the broker and that payment was calculated by the yield spread premium ("YSP").

Moreover, the legislative history of RESPA demonstrates clearly that Congress sought to outlaw certain practices and refused to empower HUD to police the reasonableness of settlement fees. In 1970, Congress adopted § 701 of the Emergency Home Finance Act, which charged HUD and the Veterans Administration with the task of prescribing standards governing the amount of closing costs on FHA-insured and VA-guaranteed loans. S. Rep. No. 93-866 (1974), *reprinted in* 1974 U.S.C.C.A.N. 6546, 6558. A joint HUD/VA study was completed in 1972, which documented an elaborate system of referral fees, kickbacks, rebates, commissions and the like as an inducement to those firms and individuals who direct payment of business and urged Congress to take immediate action to prevent such kickbacks by establishing maximum allowable settlement charges on FHA-VA transactions in specific housing market areas. *Mortgage Settlement Costs: Report of the Department of Housing and Urban Development and Veterans Administration* 3 (Mar. 1972) (Comm. Print of the Senate Comm. on Banking, Housing and Urban Affairs, 93d Cong., 2d Sess.).

Congress considered two bills aimed at addressing the problems identified in the HUD/VA Report, which differed with respect to the authority of HUD and the VA to regulate charges for settlement services. One bill regulated closing costs directly by placing a ceiling on the charges that could be imposed in a real estate closing of any federally related home loan, while the second bill regulated the underlying business relationships and procedures of which the costs were a function. In enacting RESPA, Congress chose the second approach. *See Real Estate Settlement Costs: Hearings on H.R. 9989 Before the Subcomm. on Housing of the House Comm. on Banking and Currency*, 93d Cong. 49 (1973) (testimony of Rep. Stephens) (explaining that the provisions in the proposed legislation pertaining to the reasonableness of settlement fees were eliminated).

The legislative history demonstrates that Congress did not intend for the legality of payments such as a yield spread premium to be dependent on the reasonableness of a broker's total compensation. The test Congress enacted in RESPA was whether the broker performed legitimate services in connection with each payment received, hence the fee "for" service language in § 8(c) and the fee for referral language, *i.e.*, "pursuant to," of § 8(a). Any other interpretation would fly in the face of Congress's clear intent to outlaw kickbacks and referral fees. Although Congress clearly rejected rate-setting measures, HUD has now tried to provide for rate setting through its "reasonable" overall payment analysis. Moreover, HUD is attempting to implement rate setting through an informal policy statement regarding an earlier informal policy statement, neither of which had the benefit of notice-and-comment rulemaking. Instead, HUD's 2001 Policy Statement was developed behind closed doors and without the required opportunity for the public to be heard.

The Fourth Circuit has recently rejected a similar attempt by HUD, in the same 2001 Policy Statement at issue here, to impose a reasonableness test on RESPA § 8(b). *See Boulware*, 2002 WL 1025101, *supra*. That court found that "RESPA was meant to address certain practices, not enact broad price controls." *Id.* at *5. Under HUD's interpretation, however, a single service provider would be liable for violating RESPA § 8(b) only "when it charges a fee that exceeds the reasonable value of goods, facilities, or services provided" – an inquiry that necessarily requires a determination of the appropriate maximum rate for those services. *Id.* at *4 (internal quotation marks omitted).

III. CLASS ACTIONS ARE BOTH APPROPRIATE AND NECESSARY TO REMEDY AND DETER VIOLATIONS OF RESPA

Without the enforcement mechanism of class action lawsuits, RESPA § 8(a) would become entirely ineffective.

Criminal prosecutions for violations of § 8(a) are nonexistent. Individual suits cannot effectively eliminate unlawful referral payments. Borrowers are not likely to find counsel willing to pursue litigation over a claim with an average value of less than $2,500.[9] Class actions are essential, therefore, to the effective enforcement of RESPA. Without this method of private enforcement, unlawful charges will continue with the result that the ability of many Americans to own their own home will be impaired.

Class actions serve an important function in our judicial system and can be a major force for economic justice. *See Standards and Guidelines for Litigating and Settling Consumer Class Actions*, 176 F.R.D. 375 (1997). They often provide the only effective means for challenging wrongful business conduct, stopping that conduct, and obtaining recovery of damages caused to the individual consumers in the class. Frequently, many consumers are harmed by the same wrongful, standard corporate practice. Here, Respondent's questioned conduct affects hundreds of thousands of borrowers. A handful, or even a hundred filed individual suits, could not deter Respondent from its current lucrative practice of paying for referrals and driving up the costs of home ownership. A class action is also the only means of efficiently redressing so many small claims. Hundreds of thousands of claims can be finally resolved in one action, one series of depositions and motions, and one trial. Individual actions are usually impracticable because the individual recovery would be

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[9] Although the Eighth Circuit below asserted that "Congress has guaranteed legal representation under RESPA by permitting attorneys' fees and costs as part of each allowable recovery," Pet. App. 1a, this is naïve at best. RESPA provides only that a "court *may* award to the prevailing party . . . costs . . . [and] *reasonable* attorneys' fees," 12 U.S.C. § 2607(d)(5) (emphasis added), which is far from the guarantee of recovery of an attorney's actual costs that would be needed to take on the considerable task of seeking remedies under RESPA with so small an amount at stake in any individual claim. Indeed, despite the prevalence of yield spread premiums in the mortgage industry, there have been few, if any, individual RESPA cases filed in the Eighth Circuit, or in any other circuit.

insufficient to justify the expense of bringing a separate lawsuit. Without class actions, businesses would be able to profit from their misconduct and retain their ill-gotten gains. *Id.* at 377. Class actions by consumers aggregate their power, enable them to take on economically powerful institutions, and make wrongful conduct less profitable. *Id.* The class action device is an extremely important vehicle for protecting consumers and holding corporate interests responsible for the harm that they do. *Id.* It also provides the only realistic mechanism by which injured persons can obtain injunctive relief to prohibit further illegal practices that would harm others.

As this Court recognized in *Deposit Guaranty National Bank v. Roper*, 445 U.S. 326, 338 n.9 (1980), without the prospect that individuals can reduce their costs of litigation and their attorneys' fees by allocating them among all class members who benefit from any recovery, unlawful yield spread premiums are unlikely to be challenged. The time and expense necessary to undertake such an action far exceed the value of any potential individual recovery even if the amounts are trebled. For that reason, homeowners who are charged unlawful yield spread premiums are unlikely to obtain legal redress at an acceptable cost unless they can proceed on behalf of a class of those similarly situated.

This very concern was repeatedly expressed during congressional hearings on RESPA with regard to the lack of power that an unsophisticated homeowner holds against the mortgage industry:

> The individual, untutored, inept, fragmented homeowner does not have the leverage that the savings and loan institutions, the banks, the other institutions that are lenders, have in dealing with the real estate establishment to get these settlement costs decreased, to get the premium for title insurance decreased, to do away with kickbacks, to do away with all of these other matters that add to higher settlement costs.

Real Estate Settlement Costs, FHA Mortgage Foreclosures, Housing Abandonment, and Site Selection Policies: Hearings on H.R. 13337 Before the Subcomm. on Housing of the House Comm. on Banking and Currency, 92d Cong. 576 (1972) (testimony of Earl A. Snyder, University of Maryland).

Moreover, a recent Urban Institute Study financed by HUD reveals that minorities are most harmed by the leverage that lenders and brokers possess.[10] This study found that "[t]here is no question that minorities are less likely than whites to obtain a mortgage financing and that, if successful, they receive less generous loan amounts and terms." HUD News Release, No. 99-191, *New Reports Document Discrimination Against Minorities by Mortgage Lending Institutions* at 1 (Sept. 15, 1999). The Urban Institute Study also found that African-Americans and Hispanics tend to pay higher yield spread premiums than whites and that women pay more than men. *See* Urban Institute Study at 95 n.11. This study confirms Professor Howell Jackson's finding that African-Americans and Hispanics who obtained loans from Respondent paid substantially more in closing fees and costs than other borrowers.[11]

The disproportionality of the power and resources of borrowers and lenders, such as Respondent, makes the use of the class action mechanism particularly appropriate.

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[10] *See Mortgage Lending Discrimination: A Review of Existing Evidence* (Turner & Skidmore eds., 1999) ("Urban Institute Study").

[11] "For African Americans, the average additional charge was $474 per loan, and for Hispanics, the average additional charge was $580 per loan." *Predatory Mortgage Lending Practices – Abusive Uses of Yield Spread Premiums: Hearing Before the Senate Comm. on Banking, Housing, and Urban Affairs* (Jan. 8, 2002) ("2002 Senate Hearing") (Prepared Statement of Prof. Howell E. Jackson, Finn M.W. Caspersen and Household International Professor of Law and Associate Dean for Research and Special Programs, Harvard Law School ("Jackson's Statement"), *available at* http://www.senate.gov/~banking102_01hrg/010802/index.htm) (Pet. App. 192a).

IV. HUD'S 2001 POLICY STATEMENT DEPRIVES CONSUMERS OF ANY INPUT INTO THE RULEMAKING PROCESS AND SHOULD NOT BE GIVEN DEFERENCE BY THE COURTS

The purpose of both the negotiated rulemaking process and notice-and-comment rulemaking is to allow consumers, business interests, and other interested persons to have input into an agency's regulations. *Amici* represent constituents who traditionally have little political power and whose right to be heard in administrative procedures that lead up to the promulgation of rules is of special importance. Consumer groups, including these *amici*, have consistently expressed concern at the industry's efforts to legalize predatory lending practices.[12] Testimony at one recent Senate Committee hearing on predatory lending practices was replete with statements from persuasive witnesses that HUD's unilateral action in its 2001 Policy Statement had opened the door to the abusive use of yield spread premiums. Chairman Paul Sarbanes of the Senate Banking Committee presided over the hearings, including the hearing that specifically addressed the abuse of the yield spread premiums. Senator Sarbanes noted during the hearing that the reasonableness test found in HUD's 2001 Policy Statement "undercuts" the "plain language of

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[12] In a letter to Hon. Mel Martinez, Secretary, U.S. Department of Housing and Urban Affairs, the NAACP, the National Hispanic Housing Council, and the National Council of La Raza objected to HUD's 2001 Policy Statement as undermining the ability of consumers who had been overcharged to seek any relief by prohibiting class action lawsuits: "As testimony at a January 8, 2002, hearing in the Senate Committee on Banking, Housing, and Urban Affairs made clear, most yield spread premiums increase the costs of home ownership by creating incentives for mortgage brokers to steer borrowers into higher cost loans than they otherwise qualify for. Unfortunately, as the testimony at the hearing made abundantly clear, this burden falls disproportionately on African-American and Hispanic borrowers." Letter from Raul Yzaguirre, President, National Council of La Raza, Hilary O. Shelton, Director, NAACP, Washington Bureau, and Moises Loza, Chairman, National Hispanic Housing Council, to Hon. Mel Martinez, Secretary, U.S. Department of Housing and Urban Affairs (Feb. 5, 2002).

the law, the regulations, the 1998 Congressional instructions to HUD . . . , and the 1999 HUD Policy Statement . . . [which] all make it clear that RESPA was intended to prohibit all payments that are not . . . for actual services provided." 2002 Senate Hearing, Tr. 5-6, 101; *see also id.* at 99-100 (Congress refused to grant HUD the authority to determine the reasonableness of fees when "they passed the legislation"); *id.*, Opening Statement of Chairman Paul S. Sarbanes, *available at* http://www.senate.gov/~banking/02_01hrg/010802/sarbanes.htm.

Representatives of the Mortgage Bankers Association ("MBA") and the National Association of Mortgage Brokers conceded during the hearing that it would be impossible for HUD to judge the "reasonableness" of individual yield spread premium payments. 2002 Senate Hearing, Tr. 100. Professor Howell E. Jackson of the Harvard Law School testified, "[W]hat we discovered [in the empirical study of Respondents' loan transactions] is the vast majority of yield spread premiums goes simply to increase the compensation of mortgage brokers. They do not go to reduce up-front costs." *Id.* at 82; *see also id.*, Jackson's Statement (Pet. App. 191a). Testimony also revealed that HUD was sorely misinformed as to the actual use of yield spread premiums by lenders such as Respondent. *See* 2001 Senate Hearing, Tr. 39-47.

HUD's "behind closed doors" formulation of the 2001 Policy Statement effectively circumvents the formal rulemaking process mandated by the Administrative Procedure Act ("APA"). HUD did not have authority under the APA to issue a policy statement that effected a change in the law without affording the public an opportunity to comment. *See* 5 U.S.C. §§ 551 *et seq.*

It is also clear that HUD's action came as the result of pressure from the industry, with no corresponding opportunity by consumers and the general public to have any input. *Amici* have learned that the MBA, an agent and representative of and lobbyist for Respondent and other

lenders, lobbied HUD after the publication of the Eleventh Circuit's *Culpepper* decision, to strike the "for" language of the RESPA statute and HUD's 1999 Policy Statement in its proposed 2001 Policy Statement. Indeed, the MBA provided HUD with a redlined version of HUD's 1999 Policy Statement, from which it struck out all of HUD's references requiring the lender making a payment "for," or in exchange for, services that the broker provided to the lender. *See* App., *infra*, 1a-43a. The request for these changes refutes Respondent's claim that "HUD's interpretation has been settled since at least 1999." Br. in Opp. at 21. Not only does Respondent make no attempt to reconcile HUD's 2001 interpretation with the 25 years in which HUD consistently concluded that referral payments are illegal under RESPA § 8(a) regardless of whether the total compensation received by the referring party is reasonable, but it also shows that the interpretation was not settled in 1999.

Even if HUD's 2001 Policy Statement could be squared with the plain meaning of the statute, which it cannot, there is no congressional delegation of authority that could conceivably entitle HUD's Policy Statement to *Seminole Rock* deference under these circumstances. *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410 (1945). The 2001 Policy Statement did not derive from HUD's delegated lawmaking powers; rather, it was a unilateral fix to a growing number of class action lawsuits. When an agency utilizes such informal means of interpreting regulations, its pronouncements are not entitled to the deference afforded to pronouncements that derive from delegated lawmaking powers. *Martin v. Occupational Safety & Health Review Comm'n*, 449 U.S. 144, 157 (1991).

Likewise, HUD's 2001 Policy Statement does not comport with the factors set out in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). The 2001 Policy Statement is glaringly inconsistent with HUD's previous administrative interpretations regarding what constitutes a violation of RESPA § 8(a). Until 2001, HUD had consistently as-

serted that a payment made in exchange for the referral of business was illegal, period.

When viewed through the prism of HUD's repeated inability to promulgate regulations under RESPA § 8(a), it becomes even clearer that HUD succumbed to pressure from the industry and adopted informally what it could not promulgate through the procedures prescribed in the APA. HUD has not materially revised the regulations at issue here since 1992, when it concluded a four-year-long rulemaking, with new regulations that, among other things, required yield spread premiums to be disclosed on the federally mandated HUD-1 disclosure form. *See* 24 C.F.R. Pt. 3500. In response to industry objections that yield spread premium disclosure would be confusing to borrowers, HUD conducted a negotiated rulemaking from December 1995 to May 1996 designed to reach a consensus among consumer groups and the mortgage industry regarding the legality of yield spread premiums under RESPA. *See Real Estate Settlement Procedures Act (RESPA) Disclosure of Fees Paid to Mortgage Brokers; Proposed Rule and Notice of Proposed Information Collection Requirements*, 62 Fed. Reg. 53912, 53913-15 (1997) ("Proposed Rule"). Consumer groups, including NACA, participated in the negotiated rulemaking.

During the negotiated rulemaking, the consumer groups proposed a regulation that would have allowed lenders to pay yield spread premiums so long as the yield spread premiums were paid pursuant to express agreements between brokers and borrowers containing certain terms and disclosures. The proposed agreement would have stated the broker's total compensation both in dollars and as a percent of the amount financed. The mortgage industry objected, and advocated a rule that would require only disclosing "direct" fees (*e.g.*, loan origination fees) and classifying a transfer of a table-funded loan as a secondary market transaction. *See* Proposed Rule, 62 Fed. Reg. at 53917. Under the mortgage industry's pro-

posals, yield spread premiums paid in connection with table-funded loans would be *per se* legal.

This attempt by HUD to conduct a negotiated rulemaking failed. As a result of its efforts, however, HUD concluded that "there is confusion in the minds of consumers on the functions of mortgage brokers and the sources of their fees," resulting in higher costs to consumers. *Id.* at 53913. HUD then proposed a rule that would have created a qualified "safe harbor" for lenders that paid a yield spread premium pursuant to an "honest lending contract." By virtue of this contract, the borrower would expressly authorize the lender to make a yield spread premium payment as additional compensation for the broker's services. *Id.* at 53921-22. Again, because of numerous mortgage industry objections, the proposal to impose "an honest lending contract" was not adopted.

Because HUD changed its mind and did not accord the public any formal mechanism for input, the 2001 Policy Statement is not entitled to any deference, and the Eighth Circuit's decision relying on it exclusively to decertify the class should be reversed.

CONCLUSION

Amici respectfully urge this Court to grant the petition.

Respectfully submitted.

LYNN W. JINKS, III
Counsel of Record
JINKS, DANIEL, CROW
& SEABORN, L.L.C.
219 North Prairie Street
P.O. Box 350
Union Springs, AL 36089
(334) 738-4225

ELIZABETH C. SMITHART
ATTORNEY AT LAW
214 North Prairie Street
P.O. Box 663
Union Springs, AL 36089
(334) 738-8683

Counsel for Amici Curiae

June 10, 2002

APPENDIX

APPENDIX

[MORTGAGE BANKERS ASSOCIATION'S TALKING POINTS, REDLINE VERSION OF HUD'S 1999 POLICY STATEMENT]

What we are asking for:

We are not asking for elimination of class actions or wiping out liability. The clarification is only a piece of evidence as to what HUD thinks the law is.

What we are offering:

Our suggestion: A mandatory contract between the broker and the borrower that clearly establishes the amount of the payment and the method of payment. Not just disclosure, but a binding legal contract.

Why this works for Consumers and the Senate.

First the relief we are asking for is not nearly as far reaching as consumers and the Senate may have believed. They appear to think that we wanted HUD to wipe out liability and class actions. This is not what the clarification does.

Second, the mandatory contract we are proposing directly addresses the consumer and senate issues: How much the broker is getting and what the relationship is.

The Senate and consumers do not want the retroactive relief, but they do want a better system going forward. So it's a fair compromise, especially since the relief is simply a clarification and does not have the effect of ending any suits or cutting off anybody's legal rights.

How to do it:

Issue the clarification as we have proposed in a policy statemeut published in the federal register. Simultaneously, issue an interim rule with the new broker fee agreement effective in 30 days. This takes care of the

desire of consumers and the senate to move both relief and prospective changes simultaneously.

*[64 FR 10080]**
FEDERAL REGISTER

[Vol. 64, No. 39]
Rules and Regulations
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT (HUD)

Office of the Assistant Secretary for Housing – Federal Housing Commissioner
24 CFR Part 3500
[Docket No. FR-4450-N-01]

RIN 2502-AH88
Real Estate Settlement Procedures Act (RESPA)
Amended Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers
Part IV

DATE: ~~Monday, March 1, 1999~~ July , 2001

ACTION: Amended Statement of Policy 1999-1

[*10080]

SUMMARY: This Statement of Policy sets forth the Department of Housing and Urban Development's position on the legality of lender payments to mortgage brokers in connection with federally related mortgage loans under the Real Estate Settlement Procedures Act ("RESPA") and HUD's implementing regulations. The Statement of Policy 1999-1 issued effective March 1, 1999, was promulgated to fulfill the express directive in the Conference Report on the 1999 HUD Appropriations Act that the Department clarify its position on this subject and eliminate "legal uncertainty" in this area.

HUD is aware that many court decisions have considered the Statement of Policy 1999-1 since it was issued. Although most courts have found it to articulate

the two-part test HUD intended, the Statement of Policy 1999-1 has not been uniformly interpreted. More specifically, in *Culpepper v. Irwin Mortgage Corporation*, (No. 99-13725, 11th Cir., June 15, 2001), the Eleventh Circuit Court of Appeals found the Statement of Policy 1999-1 "ambiguous" as to the proper application of the first part of its two-part test. As a consequence of that pronouncement by the highest court yet to pass on this question, there is great concern that precisely the type of legal uncertainty the Statement of Policy 1999-1 was intended to remove exists now and will continue to exist unless corrected.

Pursuant to the Conference Report directive, Section 19(a) of RESPA (12 U.S.C. 2617(a)) and 24 CFR 3500.4(a)(1)(ii), HUD clarifies through this amendment the precise nature of the two-part test for liability intended in the Statement of Policy 1999-1. In issuing this amendment, HUD does not endeavor to revisit the subject of lender payments to mortgage brokers anew.[1] It also does not address the propriety of class certification, the procedural issue pending before the court in the *Culpepper* decision. Instead, HUD seeks merely to remove any cause for confusion in the original language of the Statement of Policy 1999-1. This Amended Statement of Policy 1999-1 supersedes all intervening opinion letters or informal guidance.

In issuing this amendment, HUD continues to be guided by the fact that the ultimate issue posed under Section 8 of RESPA as it applies in this context is whether a lender payment to a mortgage broker was compensation for goods or facilities actually furnished, or services actually provided 12 U.S.C. § 2607(c). It was always the intent in the Statement of Policy 1999-1 that the question of whether a payment was for goods, services

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[1] HUD does not find it necessary or appropriate in issuing this amendment to revise the preamble to the Statement of Policy 1999-1, even though some purely historical facts recited in the preamble (such as the pendency of proposed rulemaking in this area) have since changed.

or facilities would be answered by applying not just one, but both parts of the two-part test. The amendment clarifies this point by, among other things, deleting the "for" language from the introductory statements of the first part of the test, which some had incorrectly read as asking the ultimate question to be answered in that initial step. The amendment clarifies that the first inquiry is whether compensable goods or services were actually furnished or compensable services were actually performed. This element requires there to be evidence that the mortgage broker is entitled to be compensated in the first instance, a fact that would not exist in a naked referral (*i.e.*, where the broker does nothing other than direct settlement service business in exchange for the lender payment). Where the broker does provide compensable goods, services or facilities, the question of whether the lender payment was for those compensable items is answered by turning to the determinative second step of the test. There, the total compensation received by the broker from any source must be reasonably related to the value of the goods, services or facilities being compensated. This second part of the test compares the broker's total compensation with what other brokers are paid for providing those goods, services or facilities in similar transactions in similar markets. If the mortgage broker's total compensation bears no reasonable relationship to the market value of the goods, services or facilities provided, then there is evidence that the lender's payment in excess of the market rate was not for those compensable items, but was instead a referral fee in violation of Section 8.

While this amended statement satisfies the Conferees' directive in the Conference Report on the 1999 HUD Appropriations Act that the Department clarify its position on this subject, HUD ~~believes~~ continues to believe that broad ~~legislative~~ reform along the lines specified in the HUD/Federal Reserve Board Report remains the most effective way to resolve the difficulties

and legal uncertainties under RESPA and the Truth in Lending Act (TILA) for industry and consumers alike. ~~Statutory changes~~ Changes like those recommended in the Report would, if adopted, provide the most balanced approach to resolving these contentious issues by providing consumers with better and firmer information about the costs associated with home-secured credit transactions and providing creditors and mortgage brokers with clearer rules. Such an approach is far preferable to piecemeal actions.

EFFECTIVE DATE: This Amended Statement of Policy is effective ~~March 1, 1999~~ July , 2001.

FOR FURTHER INFORMATION CONTACT: Rebecca J. Holtz, Director RESPA/ILS Division Room 9146, Department of Housing and Urban Development, Washington, DC 20410; telephone 202-708-4560, or (for legal questions) Kenneth A. Markison, Assistant General Counsel for GSE/RESPA ~~or Rodrigo Alba, Attorney for RESPA~~, Room 9262, Department of Housing and Urban Development, Washington, DC 20410; telephone 202-708-3137 (these are not toll free numbers). Hearing or speech-impaired individuals may access these numbers via TTY by calling the toll-free Federal Information Relay Service at 1-800-877-8339.

SUPPLEMENTARY INFORMATION: This Preamble to the Statement of Policy includes descriptions of current practices in the industry. It is not intended to take positions with respect to the legality or illegality of any practices; such positions are set forth in the Statement of Policy itself.

I. Background

A. General Background

The Conference Report on the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999 (H.R. Conf. Rep. No. 105-769, 105th Cong., 2d Sess. 260

(1998)) (FY 1999 HUD Appropriations Act) directs HUD to clarify its position on lender payments to mortgage brokers within 90 days after the enactment of the FY 1999 HUD Appropriations Act on October 21, 1998. The Report states that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of [Sections 8](a) or (b) of the Real Estate Settlement Procedures Act (12 U.S.C. 2601 *et seq.*) (RESPA)]" (Id.). The Report also states that the Conferees "are concerned about the legal uncertainty that continues absent such a policy statement" and "expect HUD to work with representatives of industry, Federal agencies, consumer groups, and other interested parties on this policy statement" (Id.).

This issue of lender payments, or indirect fees, to mortgage brokers has proven particularly troublesome for industry and consumers alike. It has been the subject of litigation in more than 150 cases nationwide (see additional discussion below). To understand the issue and HUD's position regarding the legality of these payments requires background information concerning the nature of the services provided by mortgage brokers and their compensation, as well as the applicable legal requirements under RESPA.

During the last seven years, HUD has conducted three rulemakings respecting mortgage broker fees. These rulemakings first addressed definitional issues and issues concerning disclosure of payments to mortgage brokers in transactions covered under RESPA. (See 57 FR 49600 (November 2, 1992); 60 FR 47650 (September 13, 1995).) Most recently in a regulatory negotiation (see 60 FR 54794 (October 25, 1995) and 60 FR 63008 (December 8, 1995)) and then a proposed rule (62 FR 53912 (October 16, 1997)), HUD addressed the issue of the legality of payments to brokers under RESPA. In the latter, HUD proposed that payments from lenders to mortgage brokers be presumed legal if the mortgage

broker met certain specified conditions, including disclosing its role in the transaction and its total compensation through a binding contract with the borrower. This rulemaking is pending.

In July 1998, HUD and the Board of Governors of the Federal Reserve delivered to Congress a joint report containing legislative proposals to reform RESPA and the Truth in Lending Act. If the proposals in this reform package were to be adopted, the disclosure and legality issues raised herein would be resolved for any mortgage broker following certain of the proposed requirements, and consumers would be offered significant new protections.

B. Mortgage Brokerage Industry

When RESPA was enacted in 1974, single family mortgages were largely originated and held by savings and loans, commercial banks, and mortgage bankers. During the 1980's and 1990's, the rise of secondary mortgage market financing resulted in new wholesale and retail entities to compete with the traditional funding entities to provide mortgage financing. This made possible the origination of loans by retail entities that worked with prospective borrowers, collected application information, and otherwise processed the data required to complete the mortgage transaction. These retail entities generally operated with the intent of developing the origination package, and then immediately transmitting it to a wholesale lender who funded the loan. The rise in technology permitted much more effective and faster exchange of information and funds between originators and lenders for the retail transaction.

Entities that provide mortgage origination or retail services and that bring a borrower and a lender together to obtain a loan (usually without providing the funds for loans) are generally referred to as "mortgage brokers." These entities serve as intermediaries between the

consumer and the entity funding the loan, and currently initiate an estimated half of all home mortgages made each year in the United States. Mortgage brokers generally fit into two broad categories: those that hold themselves out as representing the borrower in shopping for a loan, and those that simply offer loans as do other retailers of loans. The first type may have an agency relationship the borrower and, in some states, may be found to owe a [*10081] responsibility to the borrower in connection with the agency representation. The second type, while not representing the borrower, may make loans available to consumers from any number of funding sources with which the mortgage broker has a business relationship.

Mortgage brokers provide various services in processing mortgage loans, such as filling out the application, ordering required reports and documents, counseling the borrower and participating in the loan closing. They may also offer goods and facilities, such as reports, equipment, and office space to carry out their functions. The level of services mortgage brokers provide in particular transactions depends on the level of difficulty involved in qualifying applicants for particular loan programs. For example, applicants have differences in credit ratings, employment status, levels of debt, or experience that will translate into various degrees of effort required for processing a loan. Also, the mortgage broker may be required to perform various levels of services under different servicing or processing arrangements with wholesale lenders.

Mortgage brokers vary in their methods of collecting compensation for their work in arranging, processing, and closing mortgage loans. In a given transaction, a broker may receive compensation directly from the borrower, indirectly in fees paid by the wholesaler or lender providing the mortgage loan funds, or through a combination of both.

Where a broker receives direct compensation from a borrower, the broker's fee is likely charged to the borrower at or before closing, as a percentage of the loan amount (e.g., 1% of the loan amount) and through direct fees (such as an application fee, document preparation fee, processing fee, etc.).

Brokers also may receive indirect compensation from lenders or wholesalers. Such indirect fees may be referred to as "back funded payments," "servicing release premiums," or "yield spread premiums." These indirect fees paid to mortgage brokers may be based upon the interest rate of each loan entered into by the broker with the borrower. These fees have been the subject of much contention and litigation. Another method of indirect compensation, also the subject of significant controversy and uncertainty, is "volume-based" compensation. This generally involves compensation to a mortgage broker by a lender based on the volume of loans that the mortgage broker delivers to the lender in a fixed period of time. The compensation may come in the form of: (1) a cash payment to the broker based on the amount of loans the broker delivers to the lender in excess of a "threshold" or "floor amount"; or (2) provision of a lower "start rate" (often called a discount) for such loans; the compensation to the broker results from the difference in yield between the "start rate" and the loan rate. Volume based compensation may be received at settlement or well after a particular loan has closed.

Payments to brokers by lenders, characterized as yield spread premiums, are based on the interest rate and points of the loan entered into as compared to the par rate offered by the lender to the mortgage broker for that particular loan (e.g., a loan of 8% and no points where the par rate is 7.50% will command a greater premium for the broker than a loan with a par rate of 7.75% and no points). n1 In determining the price of a loan, mortgage brokers rely on rate quotes issued by lenders, sometimes several times a day. When a lender

agrees to purchase a loan from a broker, the broker receives the then applicable pricing for the loan based on the difference between the rate reflected in the rate quote and the rate of the loan entered into by the borrower. In some cases, the broker can increase its revenues by arranging a loan with the consumer at a particular rate and then, based on market changes or other factors which decrease the par rate, increase his or her fees. Some consumers allege that the compensation system for brokers results in higher loan rates for borrowers and/or that this compensation system is illegal under RESPA.

n1 The term "par rate" refers to the rate offered to the broker (through the lender's price sheets) at which the lender will fund 100% of the loan with no premiums or discounts to the broker.

Lender payments to mortgage brokers may reduce the up-front costs to consumers. This allows consumers to obtain loans without paying direct fees themselves. n2 Where a broker is not compensated by the consumer through a direct fee, or is partially compensated through a direct fee, the interest rate of the loan is increased to compensate the broker or the fee is added to principal. In any of the compensation methods described, all costs are ultimately paid by the consumer, whether through direct fees or through the interest rate.

n2 In many instances, these loans are called "no cost" or "no fee" loans. This terminology, however, may prove confusing because in such cases the costs are still paid by the borrower through a higher interest rate on the loan or by adding fees to principal. HUD's regulations implementing RESPA use the name "no cost" or "no point" loans consistent with industry practice.

C. Coverage of This Policy Statement

HUD's RESPA rules, found at 24 CFR part 3500 (Regulation X), define a mortgage broker to be "a person

(not an employee or exclusive agent of a lender) who brings a borrower and lender together to obtain a federally-related mortgage loan, and who renders * * * 'settlement services'" (24 CFR 3500.2(b)). In table funding, mortgage brokers may process and close loans in their own names. However, at or about the time of settlement, they transfer these loans to the lender, and the lender simultaneously advances the monies to fund the loan. In transactions where mortgage brokers function as intermediaries, the broker also provides loan origination services, but the loan funds are provided by the lender and the loan is closed in the lender's name.

In other cases, mortgage brokers may originate and close loans in their own name using their own funds or warehouse lines of credit, and then sell the loans after settlement in the secondary market. In such transactions, mortgage brokers effectively act as lenders under HUD's RESPA rules. Accordingly, the transfer of the loan obligation by, and payment to, these brokers after the initial funding is outside of RESPA's coverage under the secondary market exemption, found at 24 CFR 3500.5(b)(7), which states that payments to and from other loan sources following settlement are exempt from disclosure requirements and Section 8 restrictions. HUD's rule provides that in determining what constitutes a *bona fide* transfer in the secondary market, HUD considers the real source of funding and the real interest of the funding lender. (24 CFR 3500.5(b)(7).)

Because this Statement of Policy focuses on the legality of lender payments to mortgage brokers in transactions subject to RESPA, the coverage of this statement is restricted to payments to mortgage brokers in table-funded and intermediary broker transactions. Lender payments to mortgage brokers where mortgage brokers initially fund the loan and then sell the loan after settlement are outside the coverage of this statement as

exempt from RESPA under the secondary market exemption.

D. RESPA and Its Legislative History

In enacting RESPA, Congress sought to protect the American home-buying public from unreasonably and unnecessarily inflated prices in the home purchasing process (S. Rep. No. 93-866 (1974) *reprinted in* 1974 [*10082] U.S.C.C.A.N. 6548). Section 2 of the Act provides:

"significant reforms in the real estate settlement process are needed to insure that consumers throughout the Nation are provided with greater and more timely information on the nature and costs of the settlement process and are protected from unnecessarily high settlement charges caused by certain abusive practices that have developed in some areas of the country. * * * It is the purpose of this act to effect certain changes in the settlement process for residential real estate that will result — in more effective advance disclosure to home buyers and sellers of settlement costs; [and]

(2) In the elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services. * * *" 12 U.S.C. 2601.

Section 4(a) of RESPA requires the Secretary to create a uniform settlement statement which "shall conspicuously and clearly itemize all charges imposed upon the borrower and all charges imposed upon the seller in connection with the settlement" (12 U.S.C. 2603(a)).

Section 5(c) of RESPA requires the provision of a "good faith estimate of the amount or range of charges for specific settlement services the borrower is likely to incur in connection with the settlement as prescribed by the Secretary" (12 U.S.C. 2604(c)).

Section 8(a) of RESPA, prohibits any person from giving and any person from accepting any fee, kickback, or other thing of value pursuant to any agreement or

understanding that business shall be referred to any person. (See 12 U.S.C. 2607(a).) Section 8(b) also prohibits anyone from giving or accepting any portion, split, or percentage of any charge made or received for the rendering of a settlement service other than for services actually performed. (12 U.S.C. 2607(b).) Section 8(c) of RESPA provides, however, that nothing in Section 8 shall be construed as prohibiting the payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or services actually performed. (12 U.S.C. 2607(c)(2).)

Under Section 19 of RESPA, HUD is authorized to issue rules, establish exemptions, and make such interpretations as is necessary to implement the law. (12 U.S.C. 2618(a).)

RESPA's legislative history refers to HUD-VA Reports and subsequent hearings by the Housing Subcommittee as defining "major problem areas that [had to] be dealt with if settlement costs are to be kept within reasonable bounds." (S. Rep. No. 93-866, at 6547.) One "major problem area" identified was the "[a]busive and unreasonable practices within the real estate settlement process that increase settlement costs to home buyers without providing any real benefits to them." Another major concern was "[t]he lack of understanding on the part of most home buyers about the settlement process and its costs, which lack of understanding makes it difficult for a free market for settlement services to function at maximum efficiency."

The legislative history reveals that Congress intended RESPA to guard against these unreasonable and excessive settlement costs in two ways. Under Section 4, Congress sought to "mak[e] information on the settlement process available to home buyers in advance of settlement and requir[e] advance disclosures of settlement charges." (S. Rep. 93-866, at 6548.) The Senate Report explained that "home buyers who would otherwise shop around for settlement services, and thereby

reduce their overall settlement costs, are prevented from doing so because frequently they are not apprised of the costs of these services until the settlement date or are not aware of the nature of the settlement services that will be provided."

Under Section 8, Congress sought to eliminate what it termed "abusive practices" — kickbacks, referral fees, and unearned fees. In enacting these prohibitions, Congress intended that "the costs to the American home buying public will not be unreasonably or unnecessarily inflated." (S. Rep. 93-866 at 6548.) In describing the Section 8 provisions, the Senate Report explained that RESPA "is intended to prohibit all * * * referral fee arrangements whereby any payment is made or 'thing of value' is provided for the referral of real estate settlement business." (S. Rep. 93-866, at 6551.)

The legislative history adds that "[t]o the extent the payment is in excess of the reasonable value of the goods provided or services performed, the excess may be considered a kickback or referral fee proscribed by Section [8]." (S. Rep. 93-866, at 6551.) The Senate Report states that "reasonable payments in return for services actually performed or goods actually furnished" were not intended to be prohibited (Id). n3 It also provided that "[t]hose persons and companies that provide settlement services should therefore take measures to ensure that any payments they make or commissions they give are not out of line with the reasonable value of the services received." (*Id.*)

n3 One of the examples of abusive activities listed in the legislative history that RESPA was intended to remedy is "a title insurance company [that] may give 10% or more of the title insurance premium to an attorney who may perform no services for the title insurance company other than placing a telephone call to the company or filling out a simple application." (S. Rep. 93-866, at 6551.) Accordingly, where insufficient

services are provided, RESPA is intended to prohibit payment.

The Department has consistently held that the prohibitions under Section 8 of RESPA cover the activities of mortgage brokers, because RESPA applies to the origination, processing, and funding of a federally related mortgage loan. This became an issue when, in 1984, the 6th Circuit Court of Appeals held that in applying Section 8 as a criminal statute, the definition of settlement services did not clearly extend to the making of a mortgage loan. (*U.S.* versus *Graham Mortgage Corp.*, 740 F.2d 414 (6th Cir. 1984).) In 1992, Congress responded by amending RESPA to remove any doubt that, for purposes of RESPA, a settlement service includes the origination and making of a mortgage loan. (Section 908 of the Housing and Community Development Act of 1992 (Pub. L. 102-550, approved October 28, 1992; 104 Stat. 4413). At the same time, Congress also specifically made RESPA applicable to second mortgages and refinancings. (*Id.*)

E. HUD's RESPA Rules

On November 2, 1992 (57 FR 49600), the Department issued a major revision of Regulation X, the rule interpreting RESPA. The rule defined the term "mortgage broker" for the first time. Under the rule, mortgage brokers are required to disclose direct and indirect payments on the Good Faith Estimate (GFE) no later than 3 days after loan application. (See 24 CFR 3500.7(a) and (c).) Such disclosure must also be provided to consumers, as a final figure, at closing on the settlement statement. (24 CFR 3500.8; 24 CFR part 3500, Appendix A (Instructions for Filling Out the HUD-1 and HUD-1A).) On the GFE and the settlement statement, lender-paid mortgage broker fees must be shown as "Paid Outside of Closing" (P.O.C.), and not computed in arriving at totals. (See 24 CFR 3500.7(a)(2) and 24 CFR part 3500, Appendix A.) The 1992 rule treats mortgage brokers as settlement service

providers whose fees are disbursed at or before settlement, akin to title agents, attorneys, appraisers, etc., whose fees are subject to disclosure and otherwise subject to RESPA, including Section 8.

The 1992 rule did not explicitly take a position on whether yield spread premiums or any other named class of back-funded or indirect fees paid by lenders to brokers are *per se* legal or illegal. By illustration, codified as Illustrations of Requirements of RESPA, Fact Situations 5 and 12 in Appendix B [*10083] to 24 CFR part 3500, the 1992 rule specifically listed "servicing release premiums" and "yield spread premiums" as fees required to be itemized on the settlement statement. Although the 1992 rule specifically acknowledged the existence of such fees and provided illustrations of how they were to be denominated on HUD disclosure forms, this requirement was intended to ensure their disclosure, but not to create a presumption of *per se* legality or illegality.

The anti-kickback, anti-referral fee and unearned fee provisions of RESPA are implemented by 24 CFR 3500.14. Regulation X repeats the Section 8 prohibitions against compensation for the referral of settlement service business and for the giving or accepting of any portion, split or percentage of any charge other than for services actually rendered. (24 CFR 3500.14(c).) Regulation X provides that a charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates the unearned fee prohibition. (See 24 CFR 3500.14(c).) Moreover, 24 CFR 3500.14(g)(1)(iv) clarifies that Section 8 of RESPA permits "[a] payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or for services actually performed."

The Department's regulations provide, under 24 CFR 3500.14(g)(2), that:

The Department may investigate high prices to see if they are the result of a referral fee or a split of a fee. *If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided.* These facts may be used as evidence of a violation of section 8 and may serve as a basis for a RESPA investigation. High prices standing alone are not proof of a RESPA violation. The value of a referral (i.e., the value of any additional business obtained thereby) is not to be taken into account in determining whether the payment exceeds the reasonable value of such goods, facilities or services. * * * (emphasis supplied).

In addition, Regulation X clarifies that "[w]hen a person in a position to refer settlement service business * * * receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by such person." (24 CFR 3500.14(g)(3).)

Since 1992, HUD has provided various interpretations and other issuances under these rules stating the Department's position that the legality of a payment to a mortgage broker is not premised on the name of the particular fee. Rather, HUD has consistently advised that the issue under RESPA is whether the compensation to a mortgage broker in covered transactions is reasonably related to the value of the goods or facilities actually furnished or services actually performed. If the compensation, or a portion thereof, is not reasonably related to the goods or facilities actually furnished or the services actually performed, there is a compensated referral or an unearned fee in violation of Section 8(a) or 8(b) of RESPA, whether the compensation is a direct or indirect payment or a combination thereof.

F. Recent HUD Rulemaking Efforts

The Department received comments on the 1992 rule's requirement that mortgage brokers disclose indirect payments from lenders on the GFE and the settlement statement. In response, the Department reviewed whether the disclosure of indirect or back-funded fees is necessary or in the borrower's interest and whether additional rulemaking was needed to clarify the legality of fees to mortgage brokers. Brokers had alleged that these disclosures were confusing to consumers and disadvantaged brokers as compared to other originators who were within the secondary market exemption and were not required to disclose their compensation for the subsequent sale of the loan. Consumer representatives said that consumers needed to understand the existence of indirect fees and whether brokers represented consumers in shopping for loans. On September 13, 1995, the Department issued a proposed rule (60 FR 47650) and in December 1995 through May 1996, embarked on a negotiated rulemaking on these subjects.

Although the negotiated rulemaking did not result in consensus, on October 16, 1997, HUD published a proposed rule (62 FR 53912) that was shaped by views from both industry and consumer representatives provided during the negotiated rulemaking (as well as by comments received from the September 13, 1995, proposed rule (60 FR 47650)). The 1997 proposed rule proposed a qualified "safe harbor" for payments to mortgage brokers under Section 8. Under the proposal, if a broker enters into a contract with consumers explaining the broker's functions (whether or not it represented the consumer) and the total compensation the broker would receive in the transaction, before the consumer applied for a loan, HUD would presume the broker fees, both direct and indirect, to be legal. The 1997 proposal also provided, however, that this qualified safe harbor would only be available to those payments that did not exceed a test, to be established in the rule-

making, to preclude unreasonable fees. This proposal was intended, among other things, to establish that yield spread premiums paid to brokers meeting the rule's requirements were presumed legal when brokers provided consumers with prescribed information concerning the functions and compensation of mortgage brokers. The Department has received over 9,000 comments in response to this proposed rule.

G. Litigation

During the last several years, more than 150 lawsuits have been brought seeking class action certification based in whole or in part on the theory that the making of indirect payments from lenders to mortgage brokers violates Section 8 of RESPA. In various cases, plaintiffs have argued that yield spread premiums or other denominated indirect payments to brokers, regardless of their amount, constitute prohibited referral fees under Section 8(a). These plaintiffs generally argue that yield spread premiums are payments based upon the broker's ability to deliver a loan that is above the par rate. Some lawsuits have alleged that such yield spread premiums or other indirect payments are a split of fees between the lender and the broker, or are simply unearned fees and, therefore, also violate Section 8(b) of RESPA. Other challenges rely, in part, on the alleged unreasonableness of brokers' fees. These complaints assert that under the RESPA regulations, payments must bear a reasonable relationship to the market value of the good or the service provided and that payments in excess of such amounts must be regarded as forbidden referral fees.

Many of the lawsuits involve allegations that consumers were not informed by mortgage brokers concerning the mortgage brokers' role and compensation. A common element in many allegations is that borrowers were not informed about the existence or the amount of the yield spread premiums paid to the mortgage broker, and the relationship of the yield spread premium to the direct

fees that the borrower paid. The facts in these cases suggest generally that even where there were proper disclosures on the GFE and the settlement statement, borrowers allege that they were unaware of, or did not understand, that a yield spread premium was tied to the interest rate they agreed to pay, and that they could have reduced this charge or their direct [*10084] payment to the broker either by further negotiation or by engaging in additional shopping among mortgage loan providers.

Courts have been split in their decisions on these cases. Some of the decisions have concluded that yield spread premiums may be prohibited referral fees or duplicative fees in contravention of Section 8 of RESPA under the specific facts of the case. Some have held that the permissibility of yield spread premiums must be based on an analysis of whether the premiums constitute a reasonable payment, either alone or in combination with any direct fee paid by the borrower, for either the goods, services or facilities actually furnished. Because some courts have found that this necessitates an individual analysis of the facts of each transaction, some courts have denied plaintiffs' requests for class action certification. Some courts have certified a class without reaching a conclusion on the RESPA issues. Others have held that yield spread premiums constitute valid consideration to the mortgage broker in exchange for the origination of the loan and the sale of the loan to the lender. These courts have found that the payment of yield spread premiums is one method among many of compensating the broker for the origination services rendered.

H. Reform

In July 1998, the Department and the Federal Reserve Board delivered a report to Congress recommending significant improvements to streamline and simplify current RESPA and Truth In Lending Act requirements. The Report proposed that along with a tighter and more enforceable scheme for providing consumers with esti-

mated costs for settlements, an exemption from Section 8's prohibitions should be established for those entities that offer a package of settlement services and a mortgage loan at a guaranteed price, rate and points for the package early in the consumer's process of shopping for a loan. Such an approach, which also includes other additional consumer protection recommendations, would largely resolve these issues for any mortgage broker who chooses to abide by the requirements of this exemption. The Report's consumer protection recommendations included, among other items, that Congress consider establishment of an unfair and deceptive acts and practices remedy.

Under the "packaging" proposal set forth in the Report, settlement costs would be controlled more effectively by market forces. Consumers would be better able to comparison-shop, thereby encouraging creditors and others to operate efficiently and pass along discounts and lower prices. In addition, the Report's recommendations would greatly simplify compliance for the industry and clarify legal uncertainties that create liability risks.

I. This Policy Statement

This policy statement provides HUD's views of the legality of fees to mortgage brokers from lenders under existing law. In accordance with the Conference Report, in developing this policy statement, HUD met with representatives of government agencies, as well as a broad range of consumer and industry groups, including the Office of Thrift Supervision, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, the National Association of Mortgage Brokers, the Mortgage Bankers Association of America, the American Bankers Association, the Consumer Mortgage Coalition, America's Community Bankers, the Consumer Bankers Association, the Independent Bankers Association of America, AARP, the

National Consumer Law Center, Consumers Union, and the National Association of Consumer Advocates.

II. RESPA Policy Statement 1999-1

A. Introduction

The Department hereby states its position on the legality of payments by lenders to mortgage brokers under the Real Estate Settlement Procedures Act (12 U.S.C. 2601 *et seq.*) (RESPA) and its implementing regulations at 24 CFR part 3500 (Regulation X). This Statement of Policy is issued pursuant to Section 19(a) of RESPA (12 U.S.C. 2617(a)) and 24 CFR 3500.4(a)(1)(ii). HUD is cognizant of the Conferees' statement in the Conference Report on the FY 1999 HUD Appropriations Act that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of [Sections 8](a) or (b) (12 U.S.C. Sec. 2607) in its enactment of RESPA." (H. Rep. 105-769, at 260.) The Department is also cognizant of the congressional intent in enacting RESPA of protecting consumers from unnecessarily high settlement charges caused by abusive practices. (12 U.S.C. 2601.)

In transactions where lenders make payments to mortgage brokers, HUD does not consider such payments (i.e., yield spread premiums or any other class of named payments), to be illegal *per se*. HUD does not view the name of the payment as the appropriate issue under RESPA. HUD's position that lender payments to mortgage brokers are not illegal *per se* does not imply, however, that yield spread premiums are legal in individual cases or classes of transactions. The fees in cases or classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA.

~~In determining whether a payment from a lender~~ Under Section 8 of RESPA, 12 U.S.C. § 2607(c), the question is whether a lender payment to a mortgage broker is compensation for goods or facilities actually furnished,

or services actually provided. In determining whether a payment from a lender to a mortgage broker is for goods, services or facilities and therefore permissible under Section 8 of RESPA, ~~the~~ HUD apples a two-part test. The first question is whether goods or facilities were actually furnished or services were actually performed ~~for the compensation paid~~. The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker does not by itself make the payment legal. The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

In applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to goods, facilities, or services furnished or performed to determine whether it is legal under RESPA. Total compensation to a broker includes direct origination and other fees paid by the borrower, indirect fees, including those that are derived from the interest rate paid by the borrower, or a combination of some or all. The Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed. HUD believes that total compensation should be carefully considered in relation to price structures and practices in similar transactions and in similar markets.

B. Scope

In light of 24 CFR §3500.5(b)(7), which exempts from RESPA coverage *bona fide* transfers of loan obligations in the secondary market, this policy statement encompasses only transactions where mortgage brokers are not the real source of funds (i.e., table-funded transactions or transactions involving "intermediary" brokers).

In table-funded transactions, the mortgage broker originates, processes and closes the loan in the broker's own name and, at or about the time of settlement, there is a simultaneous advance of the loan funds by the lender and an assignment of the loan to that lender. (See 24 CFR 3500.2 (Definition of "table funding").) Likewise, in transactions where [*10085] mortgage brokers are intermediaries, the broker provides loan origination services and the loan funds are provided by the lender; the loan, however, is closed in the lender's name.

C. ~~Payments~~ Broker Must ~~Be for~~ Provide Compensable Goods, Facilities or Services

In the determination of whether payments from lenders to mortgage brokers are permissible under Section 8 of RESPA, the threshold question is whether there were goods or facilities actually furnished or services actually performed ~~for the total compensation paid to the mortgage broker~~. In making the determination of whether compensable services are performed, HUD's letter to the Independent Bankers Association of America, dated February 14, 1995 (IBAA letter) may be useful. In that letter, HUD identified the following services normally performed in the origination of a loan:

(a) Taking information from the borrower and filling out the application; n4

n4 In a subsequent informal interpretation, dated June 20, 1995, HUD stated that the filling out of a mortgage loan application could be substituted by a comparable activity, such as the filling out of a borrower's worksheet.

(b) Analyzing the prospective borrower's income and debt and pre-qualifying the prospective borrower to determine the maximum mortgage that the prospective borrower can afford;

(c) Educating the prospective borrower in the home buying and financing process, advising the borrower

about the different types of loan products available, and demonstrating how closing costs and monthly payments could vary under each product;

(d) Collecting financial information (tax returns, bank statements) and other related documents that are part of the application process;

(e) Initiating/ordering VOEs (verifications of employment) and VODs (verifications of deposit);

(f) Initiating/ordering requests for mortgage and other loan verifications;

(g) Initiating/ordering appraisals;

(h) Initiating/ordering inspections or engineering reports;

(i) Providing disclosures (truth in lending, good faith estimate, others) to the borrower;

(j) Assisting the borrower in understanding and clearing credit problems;

(k) Maintaining regular contact with the borrower, realtors, lender, between application and closing to appraise them of the status of the application and gather any additional information as needed;

(l) Ordering legal documents;

(m) Determining whether the property was located in a flood zone or ordering such service; and

(n) Participating in the loan closing.

While this list does not exhaust all possible settlement services, and while the advent of computer technology has, in some cases, changed how a broker's settlement services are performed, HUD believes that the letter still represents a generally accurate description of the mortgage origination process. For other services to be acknowledged as compensable under RESPA, they should be identifiable and meaningful services akin to those identified in the IBAA letter including, for

example, the operation of a computer loan origination system (CLO) or an automated underwriting system (AUS).

The IBAA letter provided guidance on whether HUD would take an enforcement action under RESPA. In the context of the letter's particular facts and subject to the reasonableness test which is discussed below, HUD articulated that it generally would be satisfied that sufficient origination work was performed to justify compensation if it found that:

- The lender's agent or contractor took the application information (under item (a)); and
- The lender's agent or contractor performed at least five additional items on the list above.

In the letter and in the context of its facts, HUD also pointed out that it is concerned that a fee for steering a customer to a particular lender could be disguised as compensation for "counseling-type" activities. Therefore, the letter states that if an agent or contractor is relying on taking the application and performing only "counseling type" services — (b), (c), (d), (j), and (k) on the list above — to justify its fee, HUD would also look to see that meaningful counseling — not steering — is provided. In analyzing transactions addressed in the IBAA letter, HUD said it would be satisfied that no steering occurred if it found that:

- Counseling gave the borrower the opportunity to consider products from at least three different lenders;
- The entity performing the counseling would receive the same compensation regardless of which lender's products were ultimately selected; *and*
- Any payment made for the "counseling-type" services is reasonably related to the services performed and not based on the amount of loan business referred to a particular lender.

In examining services provided by mortgage brokers and payments to mortgage brokers, HUD will look at the types of origination services listed in the IBAA letter to help determine whether compensable services are performed. n5 However, *the IBAA letter responded* to a program where a relatively small fee was to be provided for limited services by lenders that were brokering loans. n6

n5 In the June 20, 1995 letter, the Department clarified that the counseling test in the IBAA letter would not apply if an entity performed only non-counseling services (a, e, f, g, h, i, l, m, n) or a mix of counseling and non-counseling services (but did not rely only on the five counseling services (b, c, d, j, and k)).

n6 In the particular program reviewed by HUD in the IBAA letter, the average total compensation for performing six of the origination services listed above was below $200.

Accordingly, the formulation in the IBAA letter of the number of origination services which may be required to be performed for compensation is not dispositive in analyzing more costly mortgage broker transactions where more comprehensive services are provided. The determinative test under RESPA is the relationship of the services, goods or facilities furnished to the total compensation received by the broker (discussed below). In addition to services, mortgage brokers may furnish goods or facilities to the lender. For example, appraisals, credit reports, and other documents required for a complete loan file may be regarded as goods, and a reasonable portion of the broker's retail or "store-front" operation may generally be regarded as a facility for which a lender may compensate a broker. However, while a broker may be compensated for goods or facilities actually furnished or services actually performed, the loan itself, which is arranged by the mortgage broker, cannot be regarded as a "good" that the broker may sell to the lender and that the lender may pay for

based upon the loan's yield's relation to market value, reasonable or otherwise. In other words, in the context of a non-secondary market mortgage broker transaction, under HUD's rules, it is not proper to argue that a loan is a "good," in the sense of an instrument bearing a particular yield, thus justifying any yield spread premium to the mortgage broker, however great, on the grounds that such yield spread premium is the "market value" of the good.

D. Compensation Must Be Reasonably Related to Value of Goods, Facilities or Services

The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker, as described in the IBAA letter, does not by itself make a payment by a lender to a mortgage [*10086] broker legal. The next inquiry is whether the payment is reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed. Although RESPA is not a rate-making statute, HUD is authorized to ensure that payments from lenders to mortgage brokers are reasonably related to the value of the goods or facilities actually furnished or services actually performed, and are not compensation for the referrals of business, splits of fees or unearned fees.

In analyzing whether a particular payment or fee bears a reasonable relationship to the value of the goods or facilities actually furnished or services actually performed, HUD believes that payments must be commensurate with that amount normally charged for similar services, goods or facilities. This analysis requires careful consideration of fees paid in relation to price structures and practices in similar transactions and in similar markets. n7 If the payment or a portion thereof bears no reasonable relationship to the market value of the goods, facilities or services provided, the excess over the market rate may be used as evidence of a compensated referral or an unearned fee in violation of Section

8(a) or (b) of RESPA. (See 24 CFR 3500.14(g)(2).) Moreover, HUD also believes that the market price used to determine whether a particular payment meets the reasonableness test may not include a referral fee or unearned fee, because such fees are prohibited by RESPA. Congress was clear that for payments to be legal under Section 8, they must bear a reasonable relationship to the value received by the person or company making the payment. (S. Rep. 93-866, at 6551.)

n7 HUD recognizes that settlement costs may vary in different markets. The cost of a specific service in Omaha, Nebraska, for example, may bear little resemblance to the cost of a similar service in Los Angeles, California.

The Department recognizes that some of the goods or facilities actually furnished or services actually performed by the broker in originating a loan are "for" the lender and other goods or facilities actually furnished or services actually performed are "for" the borrower. HUD does not believe that it is necessary or even feasible to identify or allocate which facilities, goods or services are performed or provided for the lender, for the consumer, or as a function of State or Federal law. All services, goods and facilities inure to the benefit of both the borrower and the lender in the sense that they make the loan transaction possible (e.g., an appraisal is necessary to assure that the lender has adequate security, as well as to advise the borrower of the value of the property and to complete the borrower's loan).

The consumer is ultimately purchasing the total loan and is ultimately paying for all the services needed to create the loan. All compensation to the broker either is paid by the borrower in the form of fees or points, directly or by addition to principal, or is derived from the interest rate of the loan paid by the borrower. Accordingly, in analyzing whether lender payments to mortgage brokers comport with the requirements of Section 8 of RESPA, HUD believes that the totality of

the compensation to the mortgage broker for the loan must be examined. For example, if the lender pays the mortgage broker $600 and the borrower pays the mortgage broker $500, the total compensation of $1,100 would be examined to determine whether it is reasonably related to the goods or facilities actually furnished or services actually performed by the broker.

Therefore, in applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to goods, facilities, or services furnished or performed to determine whether total compensation is legal under RESPA. Total compensation to a broker includes direct origination and other fees paid by the borrower, indirect fees, including those that are derived from the interest rate paid by the borrower, or a combination of some or all. All payments, including payments based upon a percentage of the loan amount, are subject to the reasonableness test defined above. In applying this test, the Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed.

In so-called "no-cost" loans, borrowers accept a higher interest rate in order to reduce direct fees, and the absence of direct payments to the mortgage broker is made up by higher indirect fees (e.g., yield spread premiums). Higher indirect fees in such arrangements are legal if, and only if, the total compensation is reasonably related to the goods or facilities actually furnished or services actually performed.

In determining whether the compensation paid to a mortgage broker is reasonably related to the goods or facilities actually furnished or services actually performed, HUD will consider all compensation, including any volume based compensation. In this analysis, there

may be no payments merely for referrals of business under Section 8 of RESPA. (See 24 CFR 3500.14.) n8

n8 The Department generally has held that when the payment is based on the volume or value of business transacted, it is evidence of an agreement for the referral of business (unless, for example, it is shown that payments are for legitimate business reasons unrelated to the value of the referrals). (See 24 CFR 3500.14(e).)

Under HUD's rules, when a person in a position to refer settlement service business receives a payment for providing additional settlement services as part of the transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by the person. (24 CFR 3500.14(g)(3).) While mortgage brokers may receive part of their compensation from a lender, where the lender payment duplicates direct compensation paid by the borrower for goods or facilities actually furnished or services actually performed, Section 8 is violated. In light of the fact that the borrower and the lender may both contribute to some items, HUD believes that it is best to evaluate seemingly duplicative fees by analyzing total compensation under the reasonableness test described above.

E. Information Provided to Borrower

Under current RESPA rules mortgage brokers are required to disclose estimated direct and indirect fees on the Good Faith Estimate (GFE) no later than 3 days after loan application. (See 24 CFR 3500.7(a) and (b).) Such disclosure must also be provided to consumers, as a final exact figure, at closing on the settlement statement. (24 CFR 3500.8; 24 CFR part 3500, AppendixA.) On the GFE and the settlement statement, lender payments to mortgage brokers must be shown as "Paid Outside of Closing" (P.O.C.), and are not computed in arriving at totals. (24 CFR 3500.7(a)(2).) The requirement that all fees be disclosed on the GFE is intended to assure that consumers are shown the full amount of

compensation to brokers and others early in the transaction.

The Department has always indicated that any fees charged in settlement transactions should be clearly disclosed so that the consumer can understand the nature and recipient of the payment. Code-like abbreviations like "YSP to DBG, POC", for instance, have been noted. n9 Also, the Department has seen [*10087] examples on the GFE and/or the settlement statement where the identity and/or purpose of the fees are not clearly disclosed.

n9 This is an example only. HUD recognizes that current practices may leave borrowers confused. However, the use of any particular terms, including abbreviations, may not, by itself, violate RESPA. Nevertheless, going forward, HUD recommends that the disclosures on the GFE and the settlement statement be as described in the text. HUD recognizes that system changes may require time for lenders and brokers to implement.

The Department considers unclear and confusing disclosures to be contrary to the statute's and the regulation's purposes of making RESPA-covered transactions understandable to the consumer. At a minimum, all fees to the mortgage broker are to be clearly labeled and properly estimated on the GFE. On the settlement statement, the name of the recipient of the fee (in this case, the mortgage broker) is to be clearly labeled and listed, and the fee received from a lender is to be clearly labeled and listed in the interest of clarity. For example, a fee would be appropriately disclosed as "Mortgage broker fee from lender to XYZ Corporation (P.O.C.)." In the interest of clarity, other fees or payments from the borrower to the mortgage broker should identify that they are mortgage broker fees from the borrower. n10

n10 HUD recognizes that current software may not currently accommodate these additional disclosures. Both industry and consumers would be better served if

these additional disclosures were included in future forms.

There is no requirement under existing law that consumers be fully informed of the broker's services and compensation prior to the GFE. Nevertheless, HUD believes that the broker should provide the consumer with information about the broker's services and compensation, and agreement by the consumer to the arrangement should occur as early as possible in the process. Mortgage brokers and lenders can improve their ability to demonstrate the reasonableness of their fees if the broker discloses the nature of the broker's services and the various methods of compensation at the time the consumer first discusses the possibility of a loan with the broker.

The legislative history makes clear that RESPA was not intended to be a rate-setting statute and that Congress instead favored a market-based approach. (S. Rep. No. 93-866 at 6546 (1974).) In making the determination of whether a payment is *bona fide* compensation for goods or facilities actually furnished or services actually performed, HUD has, in the past, indicated that it would examine whether the price paid for the goods, facilities or services is truly a market price; that is, if in an arm's length transaction a purchaser would buy the services at or near the amount charged. If the fee the consumer pays is disclosed and agreed to, along with its relationship to the interest rate and points for the loan and any lender-paid fees to the broker, a market price for the services, goods or facilities could be attained. HUD believes that for the market to work effectively, borrowers should be afforded a meaningful opportunity to select the most appropriate product and determine what price they are willing to pay for the loan based on disclosures which provide clear and understandable information.

The Department reiterates its long-standing view that disclosure alone does not make illegal fees legal under RESPA. On the other hand, while under current law,

pre-application disclosure to the consumer is not required, HUD believes that fuller information provided at the earlie possible moment in the shopping process would increase consumer satisfaction and reduce the possibility of misunderstanding.

HUD commends the National Association of Mortgage Brokers and the Mortgage Bankers Association of America for strongly suggesting that their members furnish consumers with a form describing the function of mortgage brokers and stating that a mortgage broker may receive a fee in the transaction from a lender.

Although this statement of policy does not mandate disclosures beyond those currently required by RESPA and Regulation X, the most effective approach to disclosure would allow a prospective borrower to properly evaluate the nature of the services and all costs for a broker transaction, and to agree to such services and costs before applying for a loan. Under such an approach, the broker would make the borrower aware of whether the broker is or is not serving as the consumer's agent to shop for a loan, and the total compensation to be paid to the mortgage broker, including the amounts of each of the fees making up that compensation. If indirect fees are paid, the consumer would be made aware of the amount of these fees and their relationship to direct fees and an increased interest rate. If the consumer may reduce the interest rate through increased fees or points, this option also would be explained. HUD recognizes that in many cases, the industry has not been using this approach because it has not been required. Moreover, new methods may require time to implement. HUD encourages these efforts going forward and believes that if these desirable disclosure practices were adhered to by all industry participants, the need for more prescriptive regulatory or legislative actions concerning this specific problem could be tempered or even made unnecessary.

While the Department is issuing this statement of policy to comply with a Congressional directive that HUD clarify its position on the legality of lender payments to mortgage brokers, HUD agrees with segments of the mortgage lending and settlement service industries and consumer representatives that legislation to improve RESPA is needed. HUD believes that broad legislative reform along the lines specified in the HUD/Federal Reserve Board Report remains the most effective way to resolve the difficulties and legal uncertainties under RESPA and TILA for industry and consumers alike. Statutory changes like those recommended in the Report would, if adopted, provide the most balanced approach to resolving these contentious issues by providing consumers with better and firmer information about the costs associated with home-secured credit transactions and providing creditors and mortgage brokers with clearer rules.

III. Executive Order 12866, Regulatory Planning and Review

The Office of Management and Budget (OMB) reviewed this Amended Statement of Policy under Executive Order 12866, *Regulatory Planning and Review*. OMB determined that this Statement of Policy is a "significant regulatory action," as defined in section 3(f) of the Order (although not economically significant, as provided in section 3(f)(1) of the Order). Any changes made to the Statement of Policy subsequent to its submission to OMB are identified in the docket file, which is available for public inspection in the office of the Department's Rules Docket Clerk, Room 10276, 451 Seventh Street, SW, Washington, DC 20410-0500.

Dated: ~~February 22, 1999. William C. Apgar~~ July , 2001

John C. Weicher,

Assistant Secretary for Housing – Federal Housing Commissioner.

[FR Doc. ~~99-4921 Filed 2-26-99; 8:45 am] BILLING CODE 4210-27-P~~ Filed : : am]

----------COMPARISON OF FOOTNOTES----------

--FOOTNOTE 1–

HUD does not find it necessary or appropriate in issuing this amendment to revise the preamble to the Statement of Policy 1999-1, even though some purely historical facts recited in the preamble (such as the pendency of proposed rulemaking in this area) have since changed.

Preamble to Interim Rulemaking on Mortgage Broker Fee and Disclosure Agreement

This interim rulemaking addresses mortgage broker compensation. The Department of Housing and Urban Development has in the past issued various informal opinion letters and other guidance on this subject. Most recently, HUD addressed the legality of lender payments to mortgage brokers under Section 8 of the Real Estate Settlement Procedures Act (12 U.S.C. § 2607). Real Estate Settlement Procedures Act (RESPA) Amended Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers ("SOP 1999-1") [cite]. This rulemaking prospectively requires mortgage brokers to employ a new disclosure agreement to help eliminate consumer confusion over the amount, sources, and nature of mortgage broker compensation.

In the SOP 1999-1, HUD recognized the contours of the now existing disclosure obligations as follows:

> Under current RESPA rules mortgage brokers are required to disclose estimated direct and indirect fees on the Good Faith Estimate (GFE) no later than 3 days after loan application. (See 24 CFR 3500.7(a) and (b).) Such disclosure must also be provided to consumers, as a final exact figure, at closing on the settlement statement. (24 CFR 3500.8; 24 CFR part 3500, Appendix A.) On the GFE and the settlement statement, lender payments to mortgage brokers must be shown as "Paid Outside of Closing" (P.O.C.), and are not computed in arriving at totals. (24 CFR 3500.7(a)(2).) The requirement that all fees be disclosed on the GFE is intended to assure that consumers are shown the full amount of compensation to brokers and others early in the transaction.

64 Fed. Reg. 10086.

HUD also recognized that, while not presently required, additional disclosure of the nature, sources and

amounts of mortgage broker compensation would meaningfully improve the consumer's understanding of the payments received by the broker, and the consumer's ability to shop for alternatives. As the SOP 1999-1 stated:

> Although this statement of policy does not mandate disclosures beyond those currently required by RESPA and Regulation X, the most effective approach to disclosure would allow a prospective borrower to properly evaluate the nature of the services and all costs for a broker transaction, and to agree to such services and costs before applying for a loan. Under such an approach, the broker would make the borrower aware of whether the broker is or is not serving as the consumer' agent to shop for a loan, and the total compensation to be paid to the mortgage broker, including the amounts of each of the fees making up that compensation. If indirect fees are paid, the consumer would be made aware of the amount of these fees and their relationship to direct fees and an increased interest rate. If the consumer may reduce the interest rate through increased fees or points, this option also would be explained. HUD recognizes that in many cases, the industry has not been using this approach because it has not been required. Moreover, new methods may require time to implement. HUD encourages these efforts going forward and believes that if these desirable disclosure practices were adhered to by all industry participants, the need for more prescriptive regulatory or legislative actions concerning this specific problem could be tempered or even made unnecessary.

64 Fed. Reg. 10087.

HUD now believes that such an additional disclosure should be required on an industry-wide basis. The interim rulemaking requires mortgage brokers to enter into the Mortgage Broker Fee and Disclosure Agreement

with the consumer(s) within three days of taking an application. Compliance with this obligation, and performance of the Mortgage Broker Fee and Disclosure Agreement, shall render the mortgage broker compensation paid immune from liability under Section 8 of RESPA. The obligation to comply with the Mortgage Broker Fee and Disclosure Agreement rests solely with the mortgage broker, and no other entity shall be liable for any misrepresentation or non-performance of the brokers obligations under this agreement.

Mortgage Broker Fee and Disclosure Agreement

In the following: I = applicant; You = mortgage broker

Mortgage Broker Services. You are duly authorized and prepared to assist me in arranging mortgage financing for my home, and I engage you to provide such service. I understand that your services may include, but are not limited to the following:

- Taking my personal financial information and helping me complete my loan application
- Advising me about the different types of loan products available and demonstrating how closing costs and monthly payments could vary under each product
- Collecting financial information such as tax returns and bank statements that are part of the application process
- Initiating/ordering requests for mortgage and other loan verifications
- Initiating/ordering appraisals, inspections or engineering reports
- Providing me with required disclosures such as the truth-in-lending and good faith estimate disclosures
- Assisting me in understanding credit problems
- Performing such other services necessary to the completion of the loan application process

Amount of Broker Fee. I understand that, as compensation for your services, your total compensation from any and all sources will not exceed:

$_____ or _____ points (one point equals 1 percent of the original principal balance of the mortgage loan obtained).

Method of Broker Fee Payment. I understand that my choice as to how I want to structure my loan transaction will affect how your compensation is paid:

- *If I want to minimize my interest rate,* I may pay higher up-front points and fees and pay you directly.
- *If I want to minimize the cash I must bring to closing,* I may pay some or all of your compensation indirectly through a higher interest rate in which case the lender will pay you directly in whole or in part.

Nature of the Relationship. In connection with this Broker Fee and Disclosure Agreement and any mortgage loan, you are not acting as my agent, except where state law provides otherwise. Although you seek to assist me in meeting my financial needs, you do not distribute the products of all lenders or investors in the market and cannot guarantee the lowest price or best terms available in the market.

Termination. This agreement will continue until one of the following events occurs:

- I fail to receive loan approval;
- My loan closes;
- I terminate your services;
- You and I enter into a new Mortgage Broker Fee and Disclosure Agreement; or _____ days expire from the date of this agreement without any of the foregoing occurring.

Mortgage Broker Fee and Disclosure Acknowledgment

By signing below, we agree to the terms of this contract. Fees received under this agreement are legal and permissible under section 8 of the Real Estate Settlement Procedures Act and 24 CFR part 3500. The obligation to comply with the Mortgage Broker Fee and Disclosure Agreement rests solely with the mortgage broker, and no other entity shall be liable for any misrepresentation or non-performance of the brokers obligations under this agreement.

Signing this contract does not obligate me to obtain a mortgage loan through this mortgage broker, nor does it constitute mortgage loan approval.

*** * Applicant _____ Date_____**

*** * Applicant _____ Date_____**

_____ Date_____
Mortgage Broker Signature
Mortgage Broker License No. _____
(where applicable)

[Delivery. [Rule will provide that agreement must be delivered to borrower within three (3) business days of broker taking loan application.]